# INDEX


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 2 |
| Questions presented | 2 |
| Statutes and regulations involved | 2 |
| Statement | 2 |
| Specification of errors to be urged | 5 |
| Reasons for granting the writ | 5 |
| Appendix | 12–13 |


## CITATIONS


Cases:

| | |
|---|---|
| *Athol Mfg. Co.* v. *Commissioner*, 54 F. (2d) 230 | 10 |
| *Bankers Pocahontas Coal Co.* v. *Burnet*, 287 U.S. 308 | 7 |
| *Bertelsen* v. *White*, 58 F. (2d) 792 | 7 |
| *Buist's Estate*, 297 Pa. 537 | 10 |
| *Burnet* v. *Clark*, 287 U.S. 410 | 10 |
| *Burnet* v. *Commonwealth Improvement Co.*, 287 U.S. 415 | 9 |
| *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359 | 5 |
| *Dalmas* v. *Philipsburg & S. Val. R.R. Co.*, 254 Pa. 9 | 10 |
| *Dalton* v. *Bowers*, 287 U.S. 404 | 10 |
| *Diggs* v. *Fidelity & Deposit Co.*, 112 Md. 50 | 10 |
| *Greylock Mills* v. *White*, 55 F. (2d) 704 | 7 |
| *Handy & Harman* v. *Burnet*, 284 U.S. 136 | 8 |
| *Maney* v. *United States*, 278 U.S. 17 | 6 |
| *Maytag Co.* v. *Commissioner*, 17 B.T.A. 182 | 10 |
| *Miller* v. *Standard Nut Margarine Co.*, 284 U.S. 498 | 6 |
| *Missouri Pacific R. R. Co.* v. *Commissioner*, 22 B.T.A. 267 | 7, 10, 11 |
| *Penna. Utilities Co.* v. *Pub. Serv. Com.*, 69 Pa. S. Ct. 612 | 10 |
| *Planters Cotton Oil Co.* v. *Hopkins*, 286 U.S. 332 | 10 |
| *Sage* v. *United States*, 250 U.S. 33 | 7 |
| *Second Nat. Bank of Saginaw* v. *Woodworth*, 54 F. (2d) 672 | 7 |
| *Southern Railway Company* v. *Commissioner*, 27 B.T.A. — | 10, 11 |
| *State, use of Dodson* v. *Balto. & Lehigh R.R. Co.*, 77 Md. 489 | 10 |
| *Thom* v. *Baltimore Trust Co.*, 158 Md. 352 | 10 |
| *Tutun* v. *United States*, 270 U.S. 568 | 6 |
| *United States* v. *Ness*, 245 U.S. 319 | 6 |
| *United States* v. *Stone & Downer Co.*, 274 U.S. 225 | 7 |
| *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695 | 4, 5 |
| *York Haven W. & P. Co.* v. *Pub. Serv. Com.*, 287 Pa. 241 | 10 |

Statutes:

| | |
|---|---|
| Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077: | |
| Section 234 | 12 |

CITATIONS—Continued


| Statutes—Continued | Page |
|---|---|
| Revenue Act of 1921, c. 136, 42 Stat. 227, 254, 264, 315: | |
| Section 234 | 12 |
| Section 250 | 6 |
| Section 1318 (U.S.C., Title 26, Sec. 156) | 6 |
| Revenue Act of 1924, c. 234, 43 Stat. 253: | |
| Section 234 (U.S.C., Title 26, Sec. 986) | 12 |
| Section 274 (U.S.C., Title 26, Sec. 1048) | 6 |
| Section 1014 (U.S.C., Title 26, Sec. 156) | 6 |
| Revenue Act of 1926, c. 27, 44 Stat. 9: | |
| Section 274 (U.S.C.App., Title 26, Sec. 1048) | 6 |
| Section 1113 (U.S.C., Sup. VI, Title 26, Sec. 1672) | 6 |
| Miscellaneous: | |
| Treasury Regulations 45 (1920 Ed.): | |
| Article 544 | 12 |
| Article 563 | 13 |
| Treasury Regulations 62 (1922 Ed.): | |
| Article 545 | 13 |
| Article 563 | 13 |
| Treasury Department Regulations 65: | |
| Article 545 | 13 |
| Article 563 | 13 |

# In the Supreme Court of the United States

OCTOBER TERM, 1932

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No. —

GALEN L. TAIT, COLLECTOR OF INTERNAL REVENUE, petitioner

*v.*

WESTERN MARYLAND RAILWAY COMPANY, A CORPORATION

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**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT**

The Solicitor General, on behalf of the Collector and of the United States, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Fourth Circuit entered in the above cause on January 13, 1933.

**OPINIONS BELOW**

The opinion of the United States District Court for the District of Maryland (R. 38–45) is reported in 53 F. (2d) 211. The opinion of the Circuit Court of Appeals (R. 52–56) is not yet reported. 62 F. (2d) 933.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 13, 1933. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

### QUESTIONS PRESENTED

1. Whether an earlier decision of the Circuit Court of Appeals for the Fourth Circuit in a proceeding involving other tax years was *res adjudicata* of the issues herein.

2. Whether the discount on bonds sold prior to March 1, 1913, by respondent's predecessors could be amortized by respondent over the life of the bonds and a prorated proportion deducted annually from taxable income in the years 1920 to 1925, inclusive.

### STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are contained in the Appendix, *infra*, pp. 12–13.

### STATEMENT

This case (involving four consolidated causes) was tried before the District Court, jury being waived, upon a stipulation of facts which may be summarized as follows:

The Western Maryland Rail Road Company, a corporation of the State of Maryland, sold and issued over the period from October, 1902 to December, 1908, $42,518,000 first mortgage 4 per cent

bonds at a discount of $3,021,351.67 (R. 30). On March 5, 1908, a receiver was appointed for that company, and, in proceedings brought to foreclose a second mortgage, its entire property was sold to a reorganization committee representing the holders of bonds issued under said second mortgage (R. 30). Thereafter, the property was sold and conveyed to The Western Maryland Railway Company, a new corporation created under the laws of Maryland for the purpose of acquiring and operating said property (R. 30). As a part of the purchase price of said property The Western Maryland Railway Company assumed the obligation of the bonds which had been issued at a discount (R. 30–31).

In July and August, 1911, The Western Maryland Railway Company sold additional bonds in the face amount of $4,115,000 at a total discount of $617,100. These bonds were issued in the name of Western Maryland Rail Road Company, were identical in every way with the bonds theretofore sold at a discount by that company, and were secured by the same mortgage (R. 30).

On February 15, 1917, The Western Maryland Railway Company was consolidated with its subsidiaries, and the property conveyed to respondent, Western Maryland Railway Company, in accordance with a consolidation agreement (R. 32). Such of the aforesaid bonds as then remained outstanding were recognized by the respondent on its

books as its own obligations. However, no part of the discount at which the bonds were originally sold was brought forward as such or amortized on respondent's books, or amortized in its reports to the Interstate Commerce Commission (R. 35), nor had such discount been amortized on the books of Western Maryland Rail Road Company or The Western Maryland Railway Company (R. 31).

In the determination of respondent's taxable income for the years 1920 to 1925, inclusive, the Commissioner of Internal Revenue did not allow as a deduction from income any part of the said bond discount (R. 37). In its returns for 1920, 1921, and 1922, the respondent did not claim the right to make such deductions (R. 35–36). The respondent instituted four suits to recover taxes for the years 1920 to 1925, inclusive, two of which named the United States as defendant (for 1920 taxes) and the others of which named the Collector as defendant.

The suits were consolidated in the District Court (R. 17–21). That court gave judgment for the respondent, holding that the judgment in its favor in *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695 (C.C.A. 4th), was *res adjudicata* in the instant case.[1] The Circuit Court of Appeals affirmed the judgment of the District Court (R. 57).

[1] *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695 (C.C.A. 4th), involved a petition for review of a decision of the Board of Tax Appeals. The Board had held that the respondent was not entitled for the years 1918 and 1919 to

**SPECIFICATION OF ERRORS TO BE URGED**

The Circuit Court of Appeals erred:

1. In holding that its previous decision in *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695, was *res adjudicata* of the issues herein.

2. In failing to consider the instant case on the merits.

3. In failing to hold that the respondent was not entitled to the claimed deductions for amortization of discount on bonds sold by other corporations.

4. In affirming the judgment of the District Court.

**REASONS FOR GRANTING THE WRIT**

1. The decision of the court below that the judgment in *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695 (C.C.A. 4th), involving the tax years 1918 and 1919, was *res adjudicata* of the issues in the suits involved here, relating to the tax years 1920 to 1925, inclusive, involves a question of great importance in the administration of the revenue laws, and we believe it to be erroneous for the following reasons:

(a) The decision disregards the provisions of the Revenue Acts which treat each taxable year as a unit. Cf. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359. The statutes authorize the Commissioner

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annual deductions of an amortized portion of the discount on the bonds which had been issued by its predecessors. The decision of the Board was reversed by the Circuit Court of Appeals.

of Internal Revenue to determine a deficiency for *any year* in which he determines that the tax has been underpaid,[2] and afford to taxpayers the opportunity to bring suit for the recovery of taxes paid in any year.[3] The statutes thus authorize suits relating to the taxes for particular years without regard to litigation which may have been instituted as to other years and treat each taxable year as a separate unit.[4] The decision of the court below deprives these provisions of this effect, for under it a decision as to one year is forever binding as to later years. This result seems to be opposed to the rule that where cumulative remedies are given by statute the doctrine of *res adjudicata* is not a bar to a second suit. *United States* v. *Ness*, 245 U.S. 319; see also *Maney* v. *United States*, 278 U.S. 17, 23; *Tutun* v. *United States*, 270 U.S. 568, 580.

(b) The decision of the court below seems to be inconsistent with the decision of this Court in

[2] Section 250, Revenue Act of 1921 (c. 136, 42 Stat. 227); Section 274, Revenue Acts of 1924 (c. 234, 43 Stat. 253; U.S.C., Title 26, Sec. 1048) and 1926 (c. 27, 44 Stat. 9; U.S.C.App., Title 26, Sec. 1048).

[3] Section 1318, Revenue Act of 1921 (U.S.C., Title 26, Sec. 156); Section 1014 (a), Revenue Act of 1924 (U.S.C., Title 26, Sec. 156); Section 1113, Revenue Act of 1926 (U.S.C. Sup. VI, Title 26, Sec. 1672).

[4] The application of the doctrine of *res adjudicata* is not necessary to protect taxpayers against vexatious renewal of litigation where the applicable rules have been judicially settled, for if the conduct of taxing officers becomes unduly arbitrary or oppressive, the remedy of injunction is available. See *Miller* v. *Standard Nut Margarine Co.*, 284 U.S. 498.

*United States* v. *Stone & Downer Co.*, 274 U.S. 225, where the doctrine of *res adjudicata* was held inapplicable to decisions dealing with the proper classification of imports, and the same reasoning indicates that the doctrine should not be applied in litigation involving different tax years.

(c) The facts presented in the present suits differ from the facts considered in the earlier case. These differences in fact are discussed in the opinion of the District Court (R. 41–43), but that court rejected the Government's contention on this point, as did the court below (R. 53–54). Other differences in fact have been considered material by the Board of Tax Appeals. See *Missouri Pacific R.R. Co.* v. *Commissioner*, 22 B.T.A. 267.[5]

(d) The rule applied by the court below will necessarily result in gross inequalities in the administration of the revenue laws and give preference to

[5] It may be noted also that perhaps the parties in two of the suits here involved may be regarded as different from the parties involved in the earlier case. In two of the present cases the Collector was defendant while in the others the United States was defendant. This Court has held that a prior judgment against a Collector does not bind the Commissioner or the United States. *Bankers Pocahontas Coal Co.* v. *Burnet*, 287 U.S. 308; *Sage* v. *United States*, 250 U.S. 33. But the Court has not considered whether a different rule obtains where the situation is reversed. There are, however, District Court decisions holding that where the first suit is against the United States, judgment therein is binding in a subsequent suit against the Collector. *Second Nat. Bank of Saginaw* v. *Woodworth*, 54 F. (2d) 672 (E.D. Mich.); *Greylock Mills* v. *White*, 55 F. (2d) 704 (D. Mass.); *Bertelsen* v. *White*, 58 F. (2d) 792 (D. Mass.).

those taxpayers who successfully litigate a tax question over others who may be subject to tax liability as the result of a later decision of controlling authority laying down a different rule. For example, if the interpretation of the affiliation statutes by this Court in *Handy & Harman* v. *Burnet*, 284 U.S. 136, may not be applied to all corporations without regard to erroneous decisions granting affiliation in prior years, discrimination, injustice, and confusion will result. The startling consequences of such a rule can hardly be exaggerated. Under a rule of this kind, the interests of the Government could not be adequately protected unless appeals were taken and writs issued by this Court to review every questionable decision in Federal tax cases. Unless all such cases were brought to this Court, there would be created a class of taxpayers privileged in the permanent enjoyment of tax exemptions predicated upon the decisions of the lower Federal courts later declared to be erroneous and overruled. Decisions in suits involving particular tax years should conclusively settle the validity of the assessment or collection in question, but should be given no wider scope.

The question of the scope of the doctrine of *res adjudicata* in tax cases is of sufficient general importance to require review of this case. If the decision stands uncorrected, it will necessarily have a profound effect upon the administration of the revenue laws and upon the conduct of tax litigation by the Government, for the reasons stated above.

2. Upon the merits the case also presents a question which should be reviewed. As the court below held that its earlier decision was *res adjudicata* of the issues in this case, it did not pass upon the merits. We believe that it is clear that the petitioner was not entitled to amortize bond discount because it did not issue the bonds. The right to amortize bond discount is conferred by regulation. Articles 544 and 563, Regulations 45 (1920 ed.); Articles 545 (3) (a) and 563, Regulations 62 and 65 (*infra*, pp. 12–13). The regulations in terms limit deduction to the corporation which sells its bonds at a discount.

In its earlier decision (33 F. (2d) 695), the court below held that the respondent was entitled during the tax years there involved to amortize discount on bonds sold by its predecessors. The court placed this conclusion upon the grounds (1) that there was only a technical legal difference between the respondent and its predecessors which the court should disregard and accordingly that the respondent was entitled to make the deduction as if no reorganization had occurred; (2) that by acquiring the assets and assuming the liabilities of its immediate predecessors the respondent became entitled to deduct the bond discount.

So far as the earlier decision was based upon disregard of corporate entities, it seems to be opposed in principle to the decisions of this Court in *Burnet* v. *Commonwealth Improvement Co.*, 287 U.S.

415; *Burnet* v. *Clark,* 287 U.S. 410; *Dalton* v. *Bowers,* 287 U.S. 404. The Board of Tax Appeals has declined to follow it. See *Missouri Pacific R.R. Co.* v. *Commissioner,* 22 B.T.A. 267; *Southern Railway Co.* v. *Commissioner,* 27 B.T.A. —.

The respondent is a separate entity distinct from the corporations which issued the bonds.[6] New taxable entities succeeding to the assets and liabilities of predecessors do not necessarily acquire their right to deductions. See *Athol Manufacturing Co.* v. *Commissioner,* 54 F. (2d) 230 (C.C.A. 1st); *The Maytag Co.* v. *Commissioner,* 17 B.T.A. 182. Cf. *Planters Cotton Oil Co.* v. *Hopkins,* 286 U.S. 332. Since the petitioner sold no bonds at a discount it was not entitled through succession to a deduction for a discount incurred by others.

Nor was the respondent entitled to the deduction because it had assumed liabilities and acquired

[6] The consolidation which created the respondent was accomplished under the laws of Maryland and Pennsylvania. (Chap. 553 of the Acts of 1890 of the General Assembly of Maryland, as amended by Chap. 664 of the Acts of 1916, being Article 23, Sec. 218, Bagby's Ann. Code of Maryland; Pennsylvania Acts of March 24, 1865, P.L. 49, and April 10, 1869, P.L. 24 (R. 32).) The courts in both States hold that the consolidating companies go out of existence and that a new corporation is created. *State, use of Dodson* v. *Balto. & Lehigh R.R. Co.,* 77 Md. 489; *Diggs* v. *Fidelity & Deposit Co.,* 112 Md. 50; *Thom* v. *Baltimore Trust Co.,* 158 Md. 552; *Dalmas* v. *Philipsburg & S. Val. R.R. Co.,* 254 Pa. 9. See *Penna. Utilities Co.* v. *Pub. Serv. Com.,* 69 Pa.S.Ct. 612; *York Haven W. & P. Co.* v. *Pub. Serv. Com. et al.,* 287 Pa. 241; *Buist's Estate,* 297 Pa. 537.

assets of the predecessor corporations. In the earlier case it seems to have been considered that the issuing corporations had amortized the bond discount on their books, but the stipulation in the present case is to the contrary (R. 31). As the respondent assumed the liability on the bonds at their full face value there was no discount by it to be amortized. The Board of Tax Appeals has held that similar new corporations are not entitled to amortize discount by reason of assumption of liabilities of the issuing corporation. *Missouri Pacific R.R. Co.* v. *Commissioner,* 22 B.T.A. 267, *supra; Southern Railway Co.* v. *Commissioner,* 27 B.T.A. —, *supra.*

If the question of *res adjudicata* is reviewed by this Court, the case should also be considered on its merits, since the earlier decision of the court below is erroneous and involves, in part, a departure from principles recognized in recent decisions of this Court.

Respectfully submitted.

THOMAS D. THACHER,
*Solicitor General.*

APRIL, 1933.

## APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077:

> SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * *
>
> (2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities * * *.

[The same provision appears in Section 234 (a) (2) of the Revenue Acts of 1921 (c. 136, 42 Stat. 227, 254) and 1924 (c. 234, 43 Stat. 253, 283; U.S.C., Title 26, Sec. 986).]

Treasury Department Regulations 45 (1920 Edition):

> ART. 544. *Sale and retirement of corporate bonds.*— * * *.
>
> * * * * *
>
> (3) (a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of

discount not yet deducted) is a deductible expense for the taxable year. * * *

ART. 563. *Sale of capital stock, bonds, and capital assets.*— * * *. If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid * * *.

[The same provisions appear in Article 545 (a) (3) and Article 563 of Treasury Department Regulations 62 and 65.]

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